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Research Report on America's Cities

CITY FISCAL DISTRESS

Structural, Demographic and Institutional Causes

One of a series of Research Reports on major empirical studies of conditions and policies in America's municipalities.

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CITY FISCAL DISTRESS:

STRUCTURAL, DEMOGRAPHIC AND INSTITUTIONAL CAUSES

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CITY FISCAL DISTRESS

INTRODUCTION

The roots of local fiscal stress and crisis can be found in converging patterns of economic, social, and intergovernmental change. It is these deeper patterns, rather than short-term political or management behavior that dominates headlines, that require the attention of policy-makers at all levels.

1. The United States is undergoing a major industrial restructuring. All cities and metropolitan areas are affected by this process of economic change. For many, particularly the nation's central cities, the consequence of this process of economic change is steady erosion of their tax bases concurrent with increasing joblessness.

   - Per capita income in the largest central cities is approximately 58.5 percent of that of their suburbs on average. The range of these income disparities between cities and suburbs around this average, however, is great. The magnitude of these income disparities is a clear indicator of the disparities in their tax bases.

   - The evidence suggests that disparities in per capita income between cities and suburbs may have increased dramatically in the 1980s. Confirmation of this trend must await availability of data from the 1990 Census.

   - There are also significant differences in rates of unemployment between almost all cities and their suburbs. In a few, such as Detroit, Baltimore and St. Louis, central city unemployment rates are almost double those experienced in their suburbs.

2. *Major demographic shifts* have combined with structural economic change to erode the tax bases of central cities. More th[illegible] 5 million more people lived in poverty at the end of the decade of the 1980s than [illegible]ars previously. Over this period, poverty became increasingly concentrated in the nation's central cities. These trends result in systematic differentials among localities in income, wealth, and poverty. These differences create fiscal stresses in many central cities.

3. *Changes in the intergovernmental system* are increasing the fiscal squeeze on cities and towns throughout the United States.

   - Federal cutbacks and fiscal retrenchment in many states have significantly reduced the share of local revenues provided by the federal government and states.

   - The escalating costs of federal and stated mandated programs are placing growing fiscal burdens on cities.

   - Some states impoverish their cities by tightly regulating types of taxes cities can use and by exercising detailed controls over tax rates and assessment practices.

The current economic recession compounds the problems of cities already attempting to cope with difficult fiscal circumstances. Even without a recession and with the best practices of fiscal management, many cities and towns will face severe fiscal difficulties in the 1990s as a result of the differential effects of these trends.

I. ECONOMIC RESTRUCTURING AND FISCAL DISPARITIES

Even as all levels of government--federal, state, and local--attempt to deal with the fiscal pressures created by the recession, their economies are undergoing a process of industrial restructuring. This process is driven by new technologies, changing tastes and values of consumers, and changing patterns of regional and international competition.

No region, city or town will be immune to these forces of economic change. A 1988 study of the future of the U.S. economy concluded:[1]

> *During the next two decades, new technologies, rapid increases in foreign trade, and the tastes and values of a new generation of Americans are likely to reshape virtually every product, every service, and every job in the United States. These forces will shake the foundations of the most secure American businesses. Few features of the change seem inevitable.*

This process of industrial transformation is essential to the long-term competitiveness of the nation in the global economy and to that of U.S. regions. The strength of cities and their regional economies is directly related to their capacity to facilitate the transition to new economic functions in response to the changing requirements of the national and global economies.

But these patterns of economic change differ across regions, states, and localities. As a consequence, different cities and towns attempt to meet the needs of their residents and to balance their budgets with very different resource bases from which to derive revenues. Many jurisdictions in the United States have been adversely affected by the ongoing restructuring of their economies.

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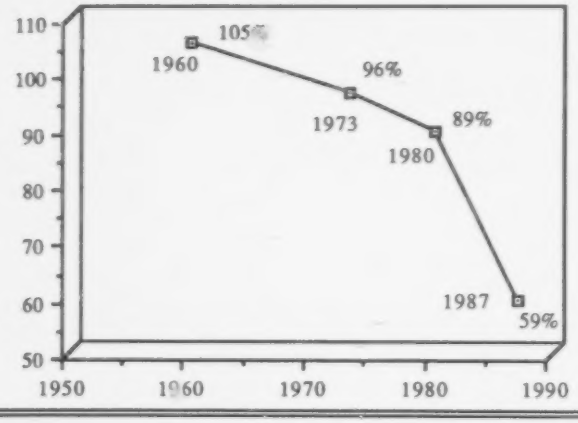
[1]U.S. Congress, Office of Technology Assessment, *Technology and the American Economic Transition: Choices for the Future* OTA-TET-283, (Washington, D.C.: U.S. Government Printing Office, May 1988), p.3.

Per capita income is a measure of the economic health of places, a reflection of the potential tax base, and an indicator of the economic welfare of a city's residents. The magnitude of disparities between per capita income of cities and their suburbs are a mirror of differences in their tax bases. For some, these disparities are sharp and distinct.

A substantial decline in the economic welfare of cities relative to their suburbs has been occurring since at least 1960, and a precipitous drop appears to have occurred in the 1980s (Figure 1). In 1960, per capita income was five percent greater in cities in metropolitan areas than in their suburbs.[2] By 1973, per capita income in cities had fallen to 96 percent of their suburbs.[3] Seven years later, in 1980, this ratio had fallen to 89 percent.[4] This decline in the economic welfare of cities relative to suburbs appears to have accelerated sharply in the 1980s. By 1987, per capita income in central cities was only 59 percent of that of their suburbs.[5]

Figure 1
Central City/Suburban Income Disparities, 1960-1987
(Central City Per Capita Income as Percent of Suburban Per Capita Income)

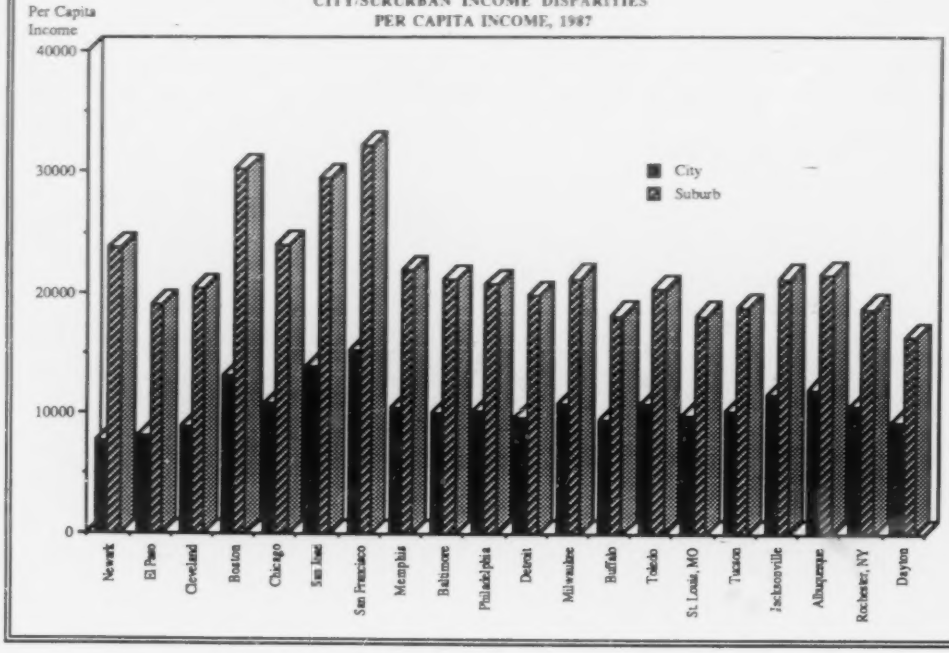


[2]Advisory Commission on Intergovernmental Relations, *Trends in Metropolitan America* (Washington, D.C.: ACIR, February 1977), p. 40.
[3]Advisory Commission on Intergovernmental Relations, *Trends in Metropolitan America* (Washington, D.C.: ACIR, February 1977), p. 40.
[4]This figure is based on a sample of the 85 largest cities in 1980. See Advisory Commission on Intergovernmental Relations, *Fiscal Disparities: Central Cities and Suburbs, 1981* (Washington, D.C.: U.S. Government Printing Office, 1984)
[5]This is the average ratio for the sample of 62 cities and their suburbs presented in the Appendix. This sample is a majority of of large cities for which 1990 Census data initially became available.

These comparisons between 1980 and 1987 must be viewed with caution.[6] Nonetheless, the orders of magnitude are striking. A great deal of attention has focused on the polarization of incomes in the United States in the last decade. These data provide a geographical dimension to this issue. Quality of life is directly related to geographical places and the economic vitality of these places. If, indeed, we are witnessing increasing disparities between per capita incomes in cities and their suburbs, the issue of the fiscal limitations of cities must be addressed anew. Final documentation of this trend toward increasing city-suburb income disparities must await the availability of data from the 1990 Census.

Figure 2 identifies 20 larger cities with very large city/suburban differences in per capita income in 1987. The range of variation in the ratio of city and suburban per capita income is large. Within this set of 20, the city with the highest per capita income, San Francisco, also has the highest suburban per capita income.

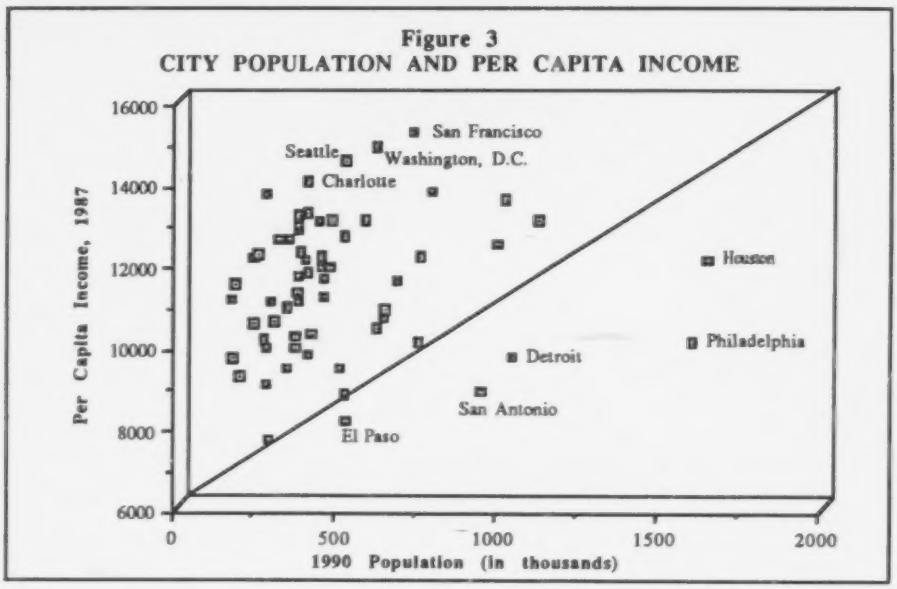
Figure 2
CITY/SURURBAN INCOME DISPARITIES
PER CAPITA INCOME, 1987



[6]Caution is required both because of the computational steps necessary to estimate 1987 per capita income for suburbs and the slightly different samples of cities used to generate the average figures for the two years.

There does not appear to be any consistent relationship between population size of cities and economic health, as measured by per capita income. As illustrated in Figure 3, the range of variation is great. Per capita income among these cities in 1987 ranged from over $15,000 in San Francisco to less than $8,000 in Louisville.[7] Some cities, such as San Francisco, Washington D.C., Seattle, and Charlotte are doing well by this measure of economic health. Other large cities like Philadelphia, Detroit, San Antonio and Philadelphia have relatively low per capita incomes. Even within the set of cities with populations between 100,000 and a half million, the variation in per capita income is extremely wide.

Figure 3
CITY POPULATION AND PER CAPITA INCOME

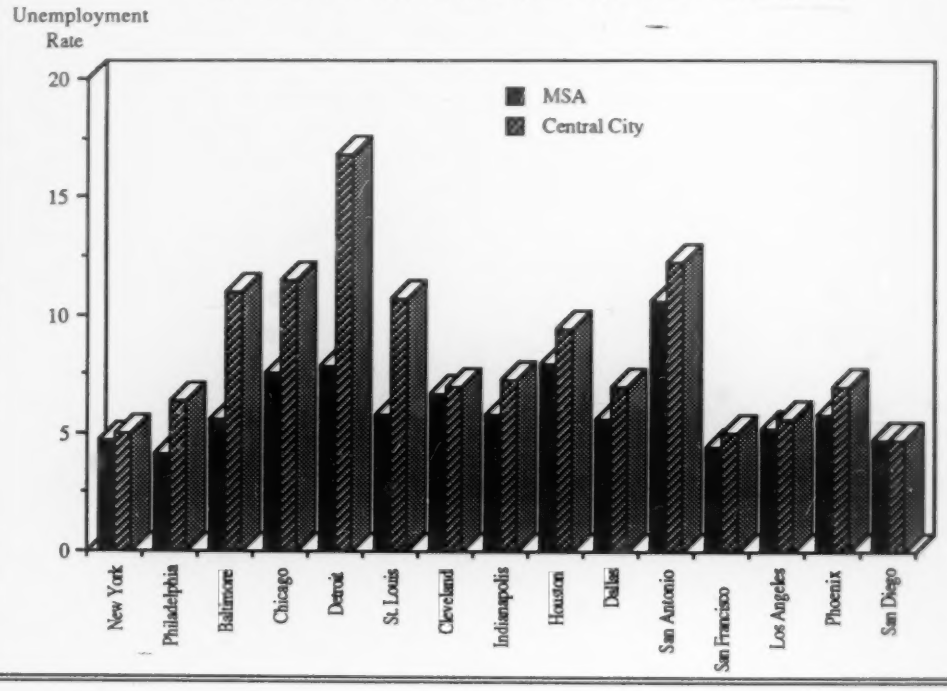


[7]Clearly, the cost of living differs significantly among the cities in Figure 3. The differences in real or cost of living adjusted per capita income would be less.

Unemployment is another measure of both the economic vitality of a city and the potential service demands of an affected population. Although data are limited, the evidence is strong that central city unemployment rates greatly exceed those of many metropolitan areas. Figure 4 examines the differentials of 15 metropolitan areas for which data are available. With the single exception of San Diego, the central cities of these areas are more sharply impacted by joblessness.

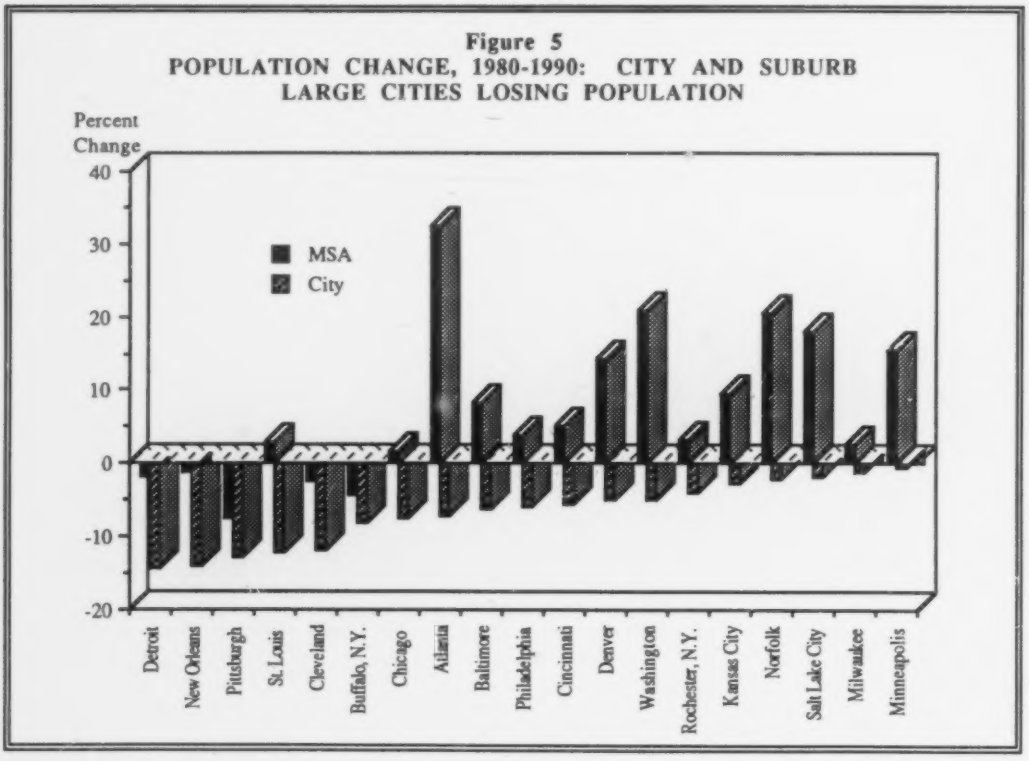
Figure 4

CITY AND METROPOLITAN UNEMPLOYMENT RATES, 1988



Demographic trends also provide a mirror of the changing economic fortunes of cities and their suburbs. Between 1980 and 1990, 19 major cities lost population (Figure 5). Of these only five were in metropolitan areas that lost population. The rest were in growing metropolitan areas, some of which were growing rapidly even as their central cities declined in size.

Figure 5
POPULATION CHANGE, 1980-1990: CITY AND SUBURB
LARGE CITIES LOSING POPULATION



II. THE BURDEN OF POVERTY

Demographic change has combined with the dramatic structural changes in the economies of central cities to erode the tax bases of many of these jurisdictions. Most important of these are the movement of higher income households from cities to suburbs and the increasing concentration of poverty in central cities and cities and towns in nonmetropolitan areas.

In 1987, NLC pointed to the linkage between the performance of the national economy and poverty (*Poverty in America: New Data, New Perspectives).*

> *The direction of this causation, however, is not only from the national economy to poverty. Poverty has a breaking influence on the vitality of the economy. Responding to the critical needs of those in poverty directs scarce national resources from other uses which might spur economic growth. Further, the segment of the poverty population which might be added to the workforce should be viewed as a national resource whose potential can promote economic growth.*

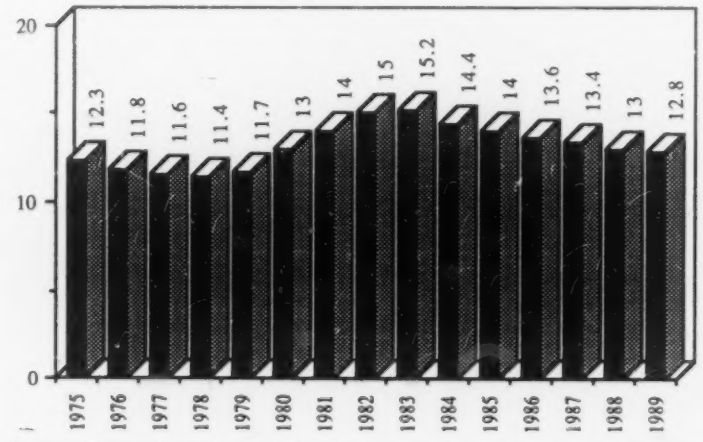
This 1987 research report documented the increasing urbanization of poverty in the United States between 1979 and 1985, a year when the rate of poverty stood at a twenty-year high (1970-1989).

A decade of structural economic change and recessions in the 1980s and early 1990s have increased poverty in the United States.

> *More than 5.5 million more people were living in poverty in 1989 than ten years previously.*

The rate at which poverty afflicted Americans increased by one percent over the decade 1979-1989 (Figure 6). This increased poverty rate accounted for fully one-half of the increase in poverty between the beginning and end of the decade. The other half occurred because of overall population growth. Recession in the early 1980s sharply increased poverty. Relative prosperity in the last five years of the decade brought this rate back to levels similar to those at the beginning of the decade.

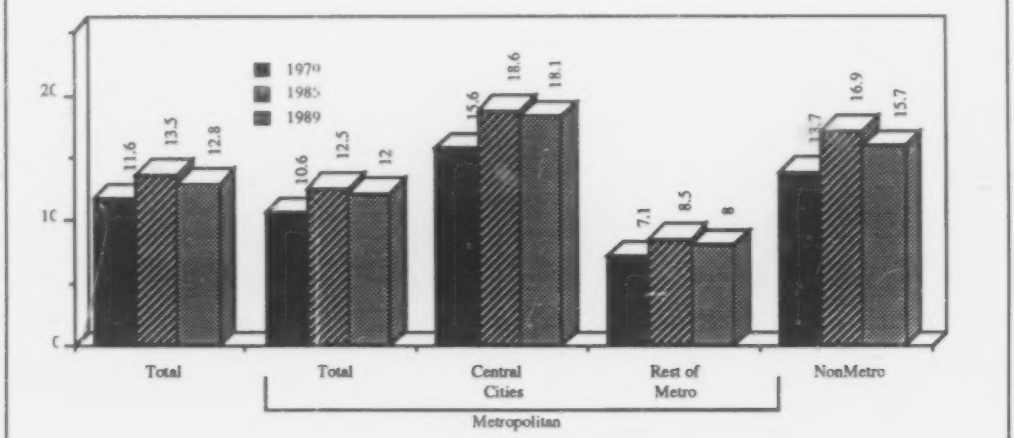
Figure 6
POVERTY RATES OF INDIVIDUALS, 1975-1989



Source: Bureau of the Census, *Money Income and Poverty Status in the United States.*

Central cities experienced the highest rates of poverty again in 1989, as they did in 1985 and in 1979 (Figure 7). By 1989, there were approximately 4.4 million more persons in poverty in central cities than in 1979. Nonmetropolitan areas continued to experience high rates of poverty. The incidence of poverty increased by two percentage points over the decade, although the number of those in poverty in nonmetropolitan areas decreased by slightly more than one million over this ten-year period.

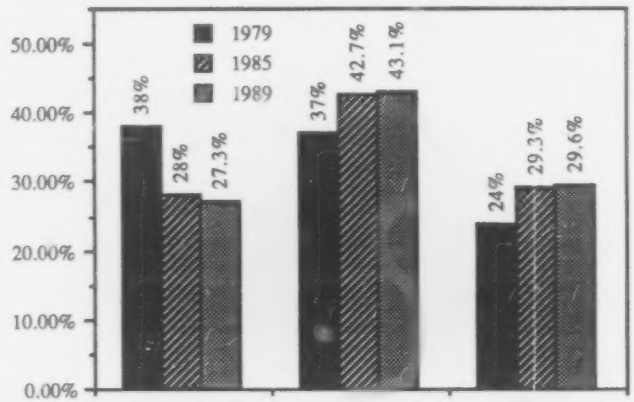
Figure 7
POVERTY RATES OF INDIVIDUALS BY TYPE OF RESIDENTS
Percent of All Persons in the Areas



The relative prosperity of the last five years of the decade did not, by this measure, favor the suburbs. Although suburbs had the lowest rates of poverty in each of the three years examined, the incidence of poverty in the suburbs of metropolitan areas decreased by only one-half of one percentage point between 1985 and 1989, the same as in the metropolitan area as a whole and in their central cities.

Slightly more than 60 percent of all those afflicted by poverty lived in metropolitan areas in 1979. The remainder lived in nonmetropolitan areas. The data do not identify how many of these were in nonmetropolitan cities and towns. The urban share of those in poverty, however, is clearly greater than simply that of central cities and their suburbs (Figure 8).

Figure 8
DISTRIBUTION OF INDIVIDUALS IN POVERTY
By Type of Residence, 1979, 1985 & 1989



Ten years later, by 1989, 72.7 percent of those in poverty were in metropolitan areas. This represents an increase of over 10 percentage points in the metropolitan share of poverty.

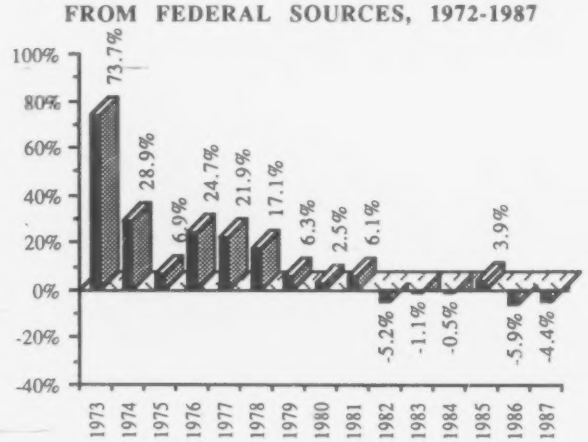
Poverty is increasingly concentrated in central cities in the United States. Over the decade, the central city's share of the nation's poor increased from 37 to 43 percent or by six percentage points. The economic recovery of the 1980s had little effect on the incidence of poverty in central cities, and their share of the nation's poor increased as the national economy grew. Although the proportion of those in poverty in suburban rings increased by over this period, sharp disparities between central cities and suburbs in both rates and shares of poverty remained at the end of the decade.

III. CHANGES WITHIN FEDERAL SYSTEM

Critics of urban fiscal management often fail to recognize how these changes within the intergovernmental systems, as well as the control states exercise over taxing sources available to cities, affect the fiscal conditions. Federal cutbacks, current budget shortfalls in many states, and escalating mandated costs are increasing the fiscal burdens of cities and towns, even as many attempt to cope with the costs of economic and demographic change.

The federal government has retreated from its commitment to the welfare of cities made in the late 1960s. Since roughly 1986, federal assistance to local governments has been declining (Figure 9).[8] Adjustment of federal assistance to local governments for inflation would further accentuate the precipitousness of the federal retreat in its commitment to local governments.

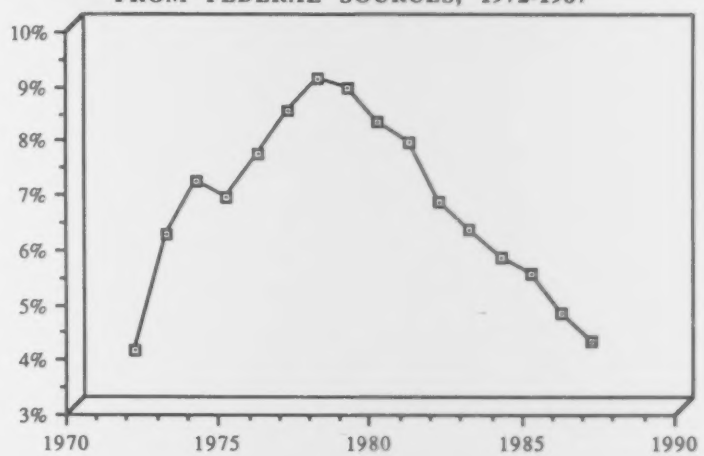
Figure 8
PERCENT CHANGE IN LOCAL REVENUES FROM FEDERAL SOURCES, 1972-1987



[8]Data for Figures 9-13 are from Advisory Commission on Intergovernmental Relations, *Significant Features of Fiscal Federalism*, (Washington, D.C.: January 1989).

The share of total local government revenues provided by the federal government, after increasing throughout the 1970s, began to decline precipitously in 1980 (Figure 10). In 1978 intergovernmental transfers from the federal government constituted 9 percent of local government revenues. By 1987, this figure had decreased to 4.2 percent. In 1986, as part of the New Federalism, general revenue sharing, a major source of unrestricted funding for cities, was eliminated. Other programs providing assistance to cities have been systematically pared or eliminated.

Figure 10
SHARE OF TOTAL LOCAL REVENUES FROM FEDERAL SOURCES, 1972-1987

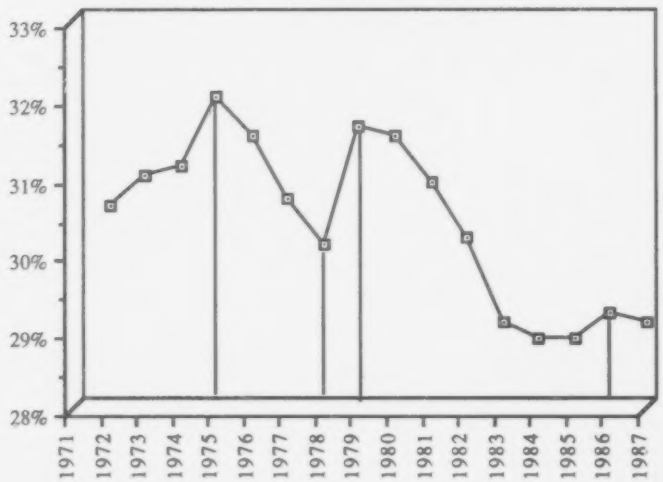


Prospects for increased federal funding to meet domestic priorities and address the problems of the nation's cities are extremely limited. Continuing federal deficits, the growing federal debt, political opposition to new taxes, and lack of political consensus on national goals effectively preclude any federal response to the needs of cities.

Even as federal assistance to cities has declined, the cost of federal mandates to cities has soared. In particular, environmental and medical care mandates, unaccompanied by federal funds for implementation, now pose major challenges to city fiscal capacities. In addition, new controls on the ability of local governments to issue bonds legislated in the 1986 Tax Act further handicap cities as they attempt to address their fiscal needs.

The ability of states to assist cities has been constrained by their own expanded responsibilities under the New Federalism and by their own budgetary problems. Between 1980 and 1985, the state share of total local revenues declined (Figure 11). Since 1985, this contribution appears to have stabilized. In 1975, the state share of total local revenues was 32 percent. By 1987, this share was 29 percent.

Figure 11
SHARE OF TOTAL LOCAL REVENUES FROM STATE SOURCES, 1972-1987



In the current recession, however, 28 states confront serious deficits that will require cutbacks in programs, including those benefiting cities, and, in some cases, tax increases. This will hamper the ability of many states to respond to fiscal stress of cities through increased assistance.

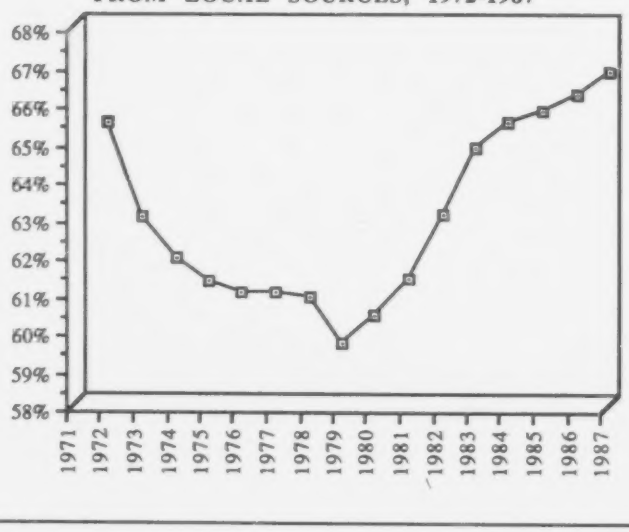
States have also increased fiscal pressures on cities through mandates. In many cases, cities are mandated by states to provide services without any state provision for funding. Some states have attempted to address this problem. California and Florida, for example, have passed reimbursement acts that require mandates to be accompanied by funding. Florida legislation permits any mandates for which funding is not provided to be ignored by local governments. Other states require fiscal notes which are financial impact

statements of the costs to local governments of pending mandate legislation. Fiscal notes, by specifying the costs of pending mandates, are intended to force consideration of costs in the legislative process.

States can impoverish their cities through state policies regulating the type of taxes local governments can use. In some states, cities may use any taxes not prohibited by state legislation. In others, cities must be authorized to used particular taxes by state legislation. In addition, some states exercise fairly detailed controls over local tax rates and assessment practices.

Local governments have not been passive over this period. The share of local revenues that had to be derived from local sources has increased sharply since 1980, after falling consistently throughout the 1970s (Figure 12). In 1979, local governments derived slightly less than 60 percent of their revenues from local sources. By 1987, this figure was almost 67 percent.

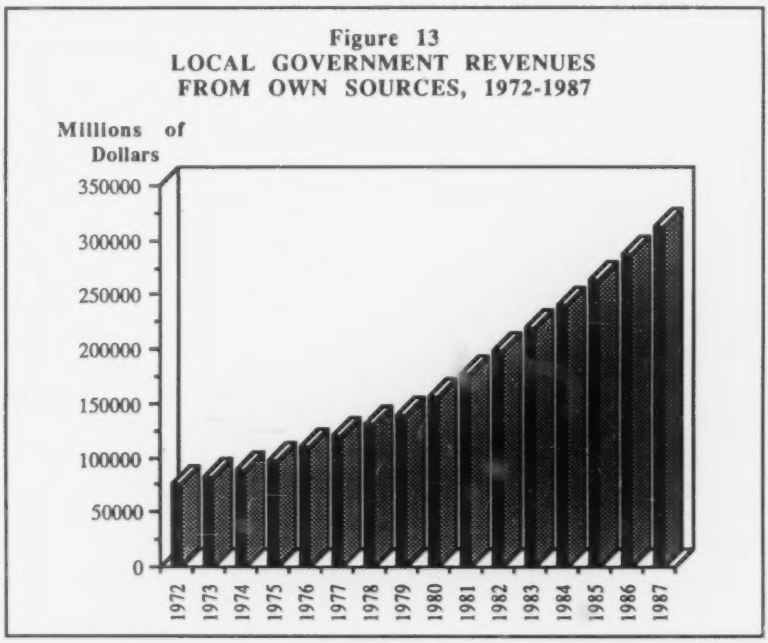
Figure 12
SHARE OF TOTAL LOCAL REVENUES FROM LOCAL SOURCES, 1972-1987



This increased local share is not an artifact of federal cutbacks. During this period local governments were significantly increasing the revenues they derived from their own sources (Figure 13). Between 1979 and 1987, locally generated revenues increased by 84.4 percent.

Despite this increased level of local revenue effort, some cities and towns are experiencing fiscal distress because of economic and demographic change, and changes and restrictions within the intergovernmental system. Fiscal crises resulting from these structural and institutional problems cannot be addressed by cities acting alone, particularly where local revenue efforts are already high.

Figure 13
LOCAL GOVERNMENT REVENUES FROM OWN SOURCES, 1972-1987



Answers must be found within the intergovernmental system, in metropolitan regionalism, and by addressing the negative tax climate that pervades cities and states. Among these are:

- The federal and state governments must recognize that cities, acting alone, cannot effectively address structural and institutionally induced fiscal distress. Both of these levels of government should consider programs to assist cities confronting budgetary problems due to these sources.

- In addition, both the federal government and states must recognize the increasing costs of mandates on cities and towns. New mandates should be accompanied by revenues for implementation, especially for local governments already confronting fiscal problems.

- The federal and local governments should recognize the burden on city fiscal systems created by the increasing concentration of the nation's poor in central cities. Poverty is not simply the responsibility of cities. Federal and state programs should assist central cities, as well as distressed jurisdictions in suburbs and nonmetropolitan areas, in responding to the needs of those in poverty.

- States should address the issue of the effects of restrictive state tax policies on the ability of local governments to respond to their fiscal problems.

- In an era of federal and state deficits, part of the answer must be found within metropolitan areas. Metropolitan areas are a single regional economy. The economic health of any jurisdiction within the region affects the health and potential of the whole. The decade of the 1990s must be a period of coalition building and tax base sharing among jurisdictions within metropolitan areas.

- An unfortunate legacy of the 1980s is the prevailing pejorative attitudes toward any new taxes, even when the need is great and the justification strong. This must change. In particular, cities cannot respond to their own fiscal needs if their ability to derive new revenues is restricted by voter unwillingness to approve new taxes or tax rates.

APPENDIX

CENTRAL CITY/SUBURBAN DISPARITIES IN INCOME

CENTRAL CITY/SUBURBAN DISPARITIES IN PER CAPITA INCOME

RANK	CITY	PER CAPITA INCOME		
		CITY 1987 ($)	SUBURBAN ($)	CITY AS PERCENT OF SUBURBAN
1	Newark	7,622	23,747	32.1%
2	El Paso	8,027	19,049	42.1%
3	Cleveland	8,690	20,305	42.8%
4	Boston	12,984	30,158	43.1%
5	Chicago	10,806	24,005	45.0%
6	San Jose	13,711	29,468	46.5%
7	San Francisco	15,137	32,315	46.8%
8	Memphis	10,347	21,919	47.2%
9	Baltimore	9,989	21,054	47.4%
10	Philadelphia	10,002	20,692	48.3%
11	Detroit	9,662	19,755	48.9%
12	Milwaukee	10,593	21,104	50.2%
13	Buffalo	9,354	18,072	51.8%
14	Toledo	10,872	20,344	53.4%
15	St. Louis, MO	9,718	18,074	53.8%
16	Tucson	10,204	18,837	54.2%
17	Jacksonville	11,514	21,136	54.5%
18	Albuquerque	11,988	21,515	55.7%
19	Rochester, NY	10,456	18,758	55.7%
20	Dayton	9,135	16,255	56.2%
21	Birmingham, AL	8,954	15,892	56.3%
22	Fresno	10,151	17,759	57.2%
23	Indianapolis	12,111	21,057	57.5%
24	Miami	9,830	16,941	58.0%
25	New Orleans	9,340	16,083	58.1%
26	Oakland	12,215	20,909	58.4%
27	Columbus	10,811	18,248	59.2%
28	Louisville	9,852	16,574	59.4%
29	Wichita	12,483	20,521	60.8%
30	Fort Worth	11,082	17,938	61.8%
31	Austin	11,860	19,103	62.1%
32	Houston	12,007	18,457	65.1%
33	Atlanta	11,689	17,892	65.3%
34	Dallas	13,489	20,415	66.1%
35	Wash. D.C.	14,778	22,310	66.2%
36	Norfolk, VA	10,070	15,165	66.4%
37	Cincinnati	11,223	16,892	66.4%
38	San Bernardino	9,623	14,471	66.5%
39	Pittsburgh	10,988	16,397	67.0%
40	Phoenix	12,375	18,353	67.4%
41	Denver	12,980	19,174	67.7%
42	Los Angeles	13,592	20,070	67.7%
43	Sacramento	11,580	17,057	67.9%
44	Portland, OR	11,830	17,293	68.4%
45	Kansas City, MO	12,077	17,552	68.8%

CENTRAL CITY/SUBURBAN DISPARITIES IN PER CAPITA INCOME

46	Omaha	12,480	18,112	68.9%
47	Tampa	11,004	15,783	69.7%
48	San Diego	12,978	18,602	69.8%
49	Minneapolis	13,092	18,675	70.1%
50	Nashville-Dvsn.	12,583	17,669	71.2%
51	Long Beach, CA	12,947	17,774	72.8%
52	Oklahoma City	11,547	15,818	73.0%
53	Seattle	14,438	19,369	74.5%
54	St. Petersburg	12,170	15,501	78.5%
55	Newport News, VA	11,396	14,463	78.8%
56	Tulsa	12,829	15,785	81.3%
57	Honolulu	14,483	17,448	83.0%
58	Riverside, CA	12,034	14,371	83.7%
59	Salt Lake City	11,064	12,590	87.9%
60	Charlotte	13,970	15,519	90.0%
61	Virginia Beach	13,141	14,455	90.9%
62	San Antonio	12,592	12,893	97.7%
	Average	10,796	18,469	58.5%

About The National League of Cities

The National League of Cities was established in 1924 by and for reform-minded state municipal leagues. It now represents 49 leagues and more than 1,400 cities directly and, through the membership of the state municipal leagues, more than 16,000 cities indirectly.

NLC serves as an advocate for its members in Washington in the legislative, administrative, and judicial processes that affect them; develops and pursues a national urban policy that meets the present and future needs of our nation's cities and the people who live in them; offers training, technical assistance and information to municipal officials to help them improve the quality of local government in our urban nation; and undertakes research and analysis on topics and issues of importance to the nation's cities.